Pitfalls of HOA Loans

Rebekah Baze
Vice President
April 21, 2010

rbaze@columbiabank.com

How do HOA loans work?

- Considered a business credit facility (as opposed to consumer) and loan is issued to the HOA as a non-profit corporation, no personal financials are reviewed
- Collateralized through the Association’s right to assess, no liens on property or any other tangible asset
- Initially set up as a non-revolving line of credit, fixed and termed at completion of work
- Draws are made against the line of credit during the project upon approval of the Construction Manager, interest only payments are made during the draw period
- Final amount actually drawn is fixed and termed upon completion of the project, line of credit is closed

Columbia Bank
Columbia State Bank

How do HOA loans work?

- No pre-payment penalty
- Line of credit rate is typically variable – based on prime (3.25% + spread)
- Term loan rate set by index, LIBOR/FHLB + (3.25% + spread)
- Repayment term set by the bank, typically 3, 5, 7 or 10 year and is based on the dollar amount as well as the scope of repair the funds are being used for
- Loan payment is a fixed, monthly payment and typically directly debited from the HOA's deposit account
- HOA is required to submit annual documentation, including annual budget showing loan commitment as a separate line item

General Underwriting Criteria

- Low delinquency rate (ideally less than 9% of the units past 60 days)
- Approximate loan amount ideally in the $20,000 - $30,000 per unit range
- Loan amount vs market value of units, ideally 20% or less
- Low ratio of renters vs. owners
- Professional reserve study, updated within the last 2 years
- Professional team executing repairs, qualifications in line with size/type of work as well as compliance with RCW 64.55 in WA (same standard applied in OR)
- Cohesive Board and evidence of owner’s support of the decision to borrow

Project Specific Underwriting Criteria

Banks manage risk when considering a loan. Additional, specific information will always be required on a per project/per property basis to fully identify, understand and mitigate any perceived risk.

- Many variables = opportunities to work around areas of perceived risk
- Key factor is the scope of repair. How risky is the proposed scope? How comprehensive are the repairs and what isn't being fixed that may end up being a problem for the HOA down the road?
- Who is preparing the design, executing the work, and providing construction management as well as contract administration services? Different firms have different strengths, and different areas of risk

Project Specific Underwriting Criteria

- Loan amount vs. current deposits – HOAs with none or very little reserve balances are considered a higher risk. If owners stop making payments, what will the HOA use to make the monthly bank payment?

- If the loan relates to construction defect litigation (prior to any settlement), what timeframe will the case settle and what is the likelihood the HOA will receive funds to both pay their loan commitment as well as execute the repairs?

- How cohesive is the Association? Is the Board functioning well and historically have the owners supported the Board's decisions?

ColumbiaBank
Columbia State Bank

Common Pitfalls of HOA Loans

- **TIMELINE** – biggest problem with HOA loans is not consulting the bank soon enough in the process. Many decisions HOAs face may affect the ability to secure a loan, its always better to bring a bank in early in the process to understand the bank’s criteria and get support to work around any problem areas

- Defining the scope of repair – consult with the bank prior to selecting a final repair scope, size of loan as well as repayment term may be affected

- Entering into contracts prior to bank approval – don’t start the work until you know you have the funds!

- Selecting unqualified service providers to execute the design/repairs – banks evaluate the risk associated with those performing design and repairs, scope creep and change order risk may have huge impact on approval

Common Pitfalls of HOA Loans

- Outdated, poorly defined or no Reserve Study – this is one of the few tools banks use to understand future commitments of the HOA

- A building envelope or property condition assessment report can replace the Reserve Study as long as it contains:

  a) description of the current components and condition of the property

  b) recommendations for what needs to be repaired

  c) clarification around what won't be fixed in a proposed scope of work

  d) future cost to fix or repair anything not included in current scope of work

- Poorly managed delinquencies – these loans are cash secured so if HOA has trouble collecting dues, risk increases for making an additional loan payment

ColumbiaBank
Columbia State Bank

Common Pitfalls of HOA Loans

- Owner buy – in: document the support of the owners, track actual numbers to show the bank the membership supports the Board's decisions

- Managing the loan payment – option for owners to pay full amount up front vs monthly payment
  - Additional administrative burden to track options
  - If owner group A pays their portion up front and others default down the road, owner group A will have to make up the shortfall
  - Additional problems if owners choose payment plan and are given the option to pay their portion in full at any time, may result in additional burden of other owners on payment plan to make the fixed, monthly payment
  - May be challenging to track/manage when units sell

Common Pitfalls of HOA Loans

- Underfunded Reserve Account – one reason HOA may be seeking loan; banks see a reserve account as a cash flow support tool in case the HOA has problems making monthly loan payment, the reserve can be tapped

- Small Associations have a much more difficult time qualifying, simply the ratio of debt per unit and perceived ability to make a loan payment

- High monthly dues – if the HOA already requires large monthly dues, how much more can the owners absorb?

Planning For HOA Loan

- Plan, plan, plan – talk to the bank early in the process to clarify their requirements and allow them to work with you through the process
- If cash flow is a problem, implement a special assessment in advance of loan request to flush out any delinquencies, prove the owners can absorb the additional payment, and build a fund to draw on if issues arise during construction
- Hire qualified professionals, will save you time and money in the long run
- Work with your professional team to determine the best way to structure the loan repayment (based on habits of owners, ability to pay up front vs those who need the monthly payment option)
- Work with a bank who can provide depository services in addition to your loan, manage your FDIC insurance (CDARS, NOW account)

Pitfalls of Special Assessments

Webinar

April 21, 2010

Presented By:
Daniel Zimberoff
Shareholder/Attorney

Barker Martin, P.S.
danzimberoff@barkermartin.com
www.barkermartin.com

Comments Re Loans

- Low ratio of renters to owners
- Professional reserve study updated w/in 2 years
- Scope of repair—construction defect
- Timeline:
  - Signing contracts
  - Loan / special assessment
- Attorney certification letter

Special Assessments

- Timing
- Owner buy-in
  - Committee
  - Pick-up truck Bob
- Vote required?
  - Look to governing documents
  - Look for monetary limitations

Approval Process

- If governing document silent, look to statute
  - Washington
    - "New Act" condo—budget ratification process
    - "Old Act" condo—per declaration
    - HOA—budget ratification process
  - Oregon
    - Condo—per governing documents
    - HOA—per governing documents

Pitfalls

- To phase or not to phase special assessments?
- Liens for assessments extinguished unless enforcement action commenced w/in 3 yrs
- Disclosure!

Pitfalls of Special Assessments

Webinar

April 21, 2010

Presented By:
Daniel Zimberoff
Shareholder/Attorney

Barker Martin, P.S.
danzimberoff@barkermartin.com
www.barkermartin.com